DELAWARE TAX INSTITUTE DECEMBER 2017
RECENT DEVELOPMENTS IN THE FEDERAL
ESTATE, GIFT AND GENERATION-SKIPPING TRANSFER TAX AREAS

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I. Estate of Powell v. Commissioner, 148 T.C. No. 18 (May 18, 2017)

In August 2008, while she was recovering from a broken hip, Nancy Powell's son, acting on her behalf under a power of attorney, transferred $10,000,000 of cash and marketable securities to a limited partnership, which had been formed by her sons, in exchange for a 99% limited partnership interest in the partnership. Mrs. Powell's two sons were the general partner, having received the 1% general partnership interest in exchange for the contribution of unsecured promissory notes to the partnership. The partnership agreement allowed for the partnership's dissolution with the written consent of all partners.

On the day that the transfers were made, Mrs. Powell's son, acting as agent under her power of attorney transferred Mrs. Powell's limited partnership interest to a charitable lead annuity trust ("CLAT"). The CLAT was to pay an annuity to the taxpayer's private foundation during her lifetime, and, upon Mrs. Powell's death, the remaining assets of the CLAT would be distributed to trusts for each of her sons. The value of the gift of the remainder of Mrs. Powell's 99% limited partnership interest to her sons was determined by assuming a 25% discount for lack of control and marketability and was supported by an independent appraisal. Mrs. Powell died seven days after the transfers were complete.

The IRS argued that the undiscounted value of the assets which Mrs. Powell transferred to the limited partnership should be included in the taxpayer's estate under Section 2036(a)(1) (based on a retained enjoyment or income), Section 2036(a)(2) (based on a retained right in conjunction with any person to designate who could enjoy the property or its income), or Section 2038 of the Internal Revenue Code (based on a power to alter, amend, revoke, or terminate the transfer at the decedent's death). Further, the IRS claimed that if the transfer to the CLAT was

valid, the assets should be included under §2035(a) (transfer of property within three years of death that otherwise would have been included in the estate under §§2036-2038 or 2042).

The Tax Court held that the assets were includible in the taxpayer's gross estate under IRC Sec. 2036(a)(2) because the decedent, despite being a limited partner, could act with her sons to dissolve the limited partnership and thus control the possession and enjoyment of the property that had been transferred to the limited partnership. The Tax Court also provided an approach to avoid double inclusion of the value of the limited partnership interest and held that the value of the assets contributed to the limited partnership less the value of the 99% limited partnership interest should be included in the estate along with the 99% limited partnership interest itself.

II. Estate of Sheldon C. Sommers et al. v. Commissioner, 149 T.C. No. 8 (August 22, 2017)

In 2001 and 2002, Sheldon Sommers went forward with a plan to transfer certain works of art from his collection to his three nieces. In order to minimize gift taxes, Mr. Sommers created an LLC, contributed the art to the LLC, and then transferred units of the LLC to his nieces, who agreed to pay any resulting gift tax. Mr. Sommers died in late 2002, and, after the Tax Court issued a decision in the estate's tax deficiency case, Mr. Sommers's nieces paid the tax due on the gifts.

Mr. Sommers's estate claimed that the inclusion of the gift tax paid by the nieces in the estate was offset by a deduction under section 2053(a). The Tax Court rejected this claim because the gift tax wasn't paid until after the decedent's death. The Tax Court state that if the estate had paid the gift tax liability, the estate would have been entitled to reimbursement from Mr. Sommers's nieces based on their agreements governing the gifts. However, since the estate did not pay the tax, the estate could not deduct the tax amount.

Mr. Sommers's estate also made a request for summary judgment regarding the amount of the marital deduction under section 2053(a), The Tax Court denied the request because the amount of the deduction was based on a factual inquiry to determine how the assets otherwise exempt from taxation were used to pay the estate's debts and expenses.

Finally, the estate claimed that the estate tax should be apportioned to the nieces under the New Jersey apportionment statute, which applies ''[w]henever a fiduciary has paid or may be required to pay an estate tax under any law of the State of New Jersey or of the United States upon or with respect to any property required to be included in the gross tax estate of a decedent

under the provisions of any law.'' In such a case, the statute provides that the tax ''be apportioned among the fiduciary and each of the transferees interested in the gross tax estate.''

The Tax Court determined reasoned that "the better reading of the New Jersey apportionment statute would interpret its text to provide for the apportionment of Federal estate tax only to transferees who receive nonprobate property included in the decedent's gross estate." The Tax Court then determined that the statute did not apply in this case because Mr. Sommers's nieces were not transferees to whom estate tax liability could be apportioned and because, in any event, the LLC units the nieces received were not included in the decedent's gross estate and were not included in computing the estate's federal estate tax liability.

III. Estate of Sower v. Commissioner, 149 T.C. No. 11 (September 11, 2017)

Frank Sower died in 2012 and his estate elected portability of his DSUE amount. When Mr. Sower's estate filed its estate tax return, the estate did not use all of the basic exclusion amount allowed under section 2010(c)(3), and his estate elected portability of the DSUE amount. The IRS issued a closing letter that sated that the return had been accepted as filed and showed no estate tax liability for Mr. Sower's estate. Further, the letter provided that the "IRS will not reopen or examine this return unless ... notified of changes to the return or there is: (1) evidence of fraud, malfeasance, collusion, concealment or misrepresentation of a material fact; (2) a clearly defined substantial error based upon established Internal Revenue Service position; or (3) a serious administrative error."

Mrs. Sower dies the following year and her estate sought to offset any taxes due through the use of Mr. Sower's DSUE, as reported on his federal estate tax return. The IRS examined the federal estate tax return filed by Mrs. Sower's estate, and, in connection with that examination, determined that the DSUE available to Mrs. Sower's estate should be reduced by the amount of taxable gifts given by Mr. Sowers during his lifetime. As a result of that adjustment, the IRS determined that there was a deficiency on Mrs. Sower's federal estate tax return.

Mrs. Sower's estate filed a petition with the Tax Court and asserted that the IRS could not reexamine the estate tax return filed by Mr. Sower in order to adjusting the amount of the DSUE allowable to Mrs. Sower's estate.

However, the Tax Court held that the IRS may consider the estate tax return of a predeceased spouse in order to calculate the correct amount of the DSUE allowable to the estate of a surviving spouse.

In addition, the Tax Court held that the closing letter issued to Mr. Sower's estate was not a closing agreement and did not preclude the IRS from evaluating the amount of the DSUE available to Mrs. Sower's estate.